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SUBJECT: SPAIN'S COAL INDUSTRY: THE WAY FORWARD

REF: A. 05 MADRID 00393

[B](#). 04 MADRID 04613

[C](#). 04 MADRID 04241

[D](#). 05 MADRID 00649

[1](#)1. SUMMARY: Coal is currently a critical part of the Spanish energy industry, although its domestic production continues to rely on public subsidies to remain viable. The recent moratorium on EU coal subsidies to Spain will force the Spanish government to re-examine the future of the industry. Pressure from the EU, Kyoto Protocol obligations and the high cost of domestic coal production makes it likely that Spain will seek to reform its coal industry in search of more efficient methods of production and power generation. This will mean reorienting industry focus on research and development, an area traditionally underfunded by the Spanish government. Coal industry jobs have been a politically sensitive topic, although alternative employment efforts and the EU mandate to reduce production has lowered this sensitivity, allowing the Spanish government more latitude in its actions. The Zapatero government will need to balance political, financial and environmental concerns as it formulates a viable plan for the future of its domestic coal production industry. END SUMMARY

//MARKET OVERVIEW//

[1](#)2. Spain has been undergoing a steady transformation in the energy market, shifting away from traditional energy sources, such as coal, and focusing more on natural gas and renewables. At this time, the Spanish energy sector is lead by petroleum, which accounts for 53 percent of the market. Natural gas is second, at 16.3 percent, recently passing coal, which provides 15.6 percent of Spanish energy. However, in electricity generation, coal remains the leader with 29 percent of electricity production, almost equaling petroleum and natural gas combined. Of note, nuclear energy accounts for about 23.6 percent of electricity production in Spain. Spain has twenty coal-fired plants, with half of them located around mining sites in northwestern Spain, including four in the province of Asturias and four in Leon along the area bordering Asturias. The remaining plants are mostly located in the littoral regions in the east and south of Spain.

[1](#)3. Domestically, Spain produced approximately 12.3 million tons of coal in 2004, accounting for about 33 percent of consumption. The main centers of production are: Leon (5.2 million tons), Aragon (3.1 million tons), Asturias (1.7 million tons), Cordoba (835,000 tons), Ciudad Real (730,000 tons) and Catalonia (286,000 tons). Lignite coal is produced only in Galicia, with centers in Garcia and Meirama. Spain imported 24.6 million tons of coal in 2004, with the largest suppliers being: South Africa (10.2 million tons), Indonesia (3.5 million tons), Russia (3.3 million tons), Australia (3.2 million tons) and the United States (2 million tons). Approximately 73% of Spain's imported coal is used in the production of electricity. Of note, imported coal is cheaper and, on average, contains fewer contaminants than domestic coal.

[1](#)4. Currently, there are forty-one companies working in the Spanish coal industry, employing a total of approximately 18,000 workers. The largest employer is the sole state-owned company, Hunosa, which employs 4,100 workers (in addition to 386 Czech contractors) and produces 1.6 million tons of coal per year. Eight of the companies operating in Spain have less than 25 employees, eleven have between 25-50 employees, eight have between 50-100 employees, seven have between 100-500 employees and seven have more than 500 employees. The eight largest companies account for almost 75 percent of coal production in Spain.

//BACKGROUND AGREEMENTS//

[1](#)5. In 1990, the Spanish government stopped mandating coal prices and coal companies today negotiate market prices directly with the electrical companies. In 1997, Spain enacted an action plan for the coal industry covering the time period 1998-2005. The plan, which was agreed to by labor groups, would lead to a gradual reduction in domestic production. Under this plan, Spain has reduced its coal-mining workforce from 24,000 to approximately 18,000 workers, mostly through early retirement incentives for those workers aged 52 and above. It also provided for the government to guarantee consumption of the coal produced

domestically, with subsidies granted to electrical companies for buying domestic. In 2004, Spain paid 260 million Euros (338 million USD) to electrical companies as an incentive to use coal that is produced in the region in which they are operating. The Spanish government has produced a continuation of this plan covering the year 2006-2012, recognizing that domestic production will be gradually scaled down in accordance with EU guidelines.

16. In July 2002, new EU regulations took effect, which dictated that Spain must lower its coal production by 65 percent over the next ten years. The regulation also stated that coal mines that do not improve their economic viability would only be able to receive production subsidies until 2008. The European Commission also proposed a new state aid program for coal, establishing the continuation of subsidies for hard coal production in member states through December 31, 2010. The Commission wanted to establish measures that will promote the development of renewable energy sources while maintaining a minimum level of subsidized coal production in the European Union as an "indigenous primary energy base". The guiding principle was that subsidized coal production would be limited to the minimum necessary for energy security: maintaining access to coal reserves, keeping equipment in an operational state, preserving the professional qualifications of a nucleus of coal miners, and safeguarding technological expertise. According to Ministry of Industry, Commerce and Tourism officials, the Spanish government considers it to be in their strategic energy interest to preserve coal production because it is a domestic energy source that is not subject to the price fluctuations common to the petroleum market.

//EU SUBSIDIES FROZEN//

17. In 2003, Spain received over 4 billion Euros (5.2 billion USD) in public assistance from the EU, accounting for .54 percent of the Spanish GDP. Of that amount, 1.125 billion Euros (1.46 billion USD) was used to subsidize coal production. However, in March 2004, the EU opened an investigation into Spanish coal-related activities, amid allegations that the Spanish government was improperly using these funds. Between 2003-2005, Spain received 5 billion Euros (6.5 billion USD) in coal subsidies, which was to be used towards the restructuring of the coal industry with two goals: to help improve production efficiency and to decrease coal extraction activity. Some specific EU allegations include: that certain coal production centers were not closed by specific dates, as mandated in the aid package, and that aid destined to cover the exceptional costs of transition to higher efficiency plants was used to aid coal extraction. An additional factor is that Spain allocates more than 60 percent of coal aid to state-owned Hunosa, a company which claims that it can't cut production costs any further despite the fact that its coal is seven times the cost of imported coal. Hunosa is also not considered to be an operation that could successfully transition to higher efficiency plants. The EU claims that the Spanish authorities have failed to adequately respond to EU inquiries on this matter and have announced that it is freezing coal sector funds to Spain. This development may endanger future coal aid from the EU, of which Spain is scheduled to receive from 8-10 billion Euros (10.4-13 billion USD) between 2005-2012.

//CO2 EMISSIONS//

18. Spain is struggling to meet its EU and Kyoto Protocol obligations to reduce CO2 emissions. Spain's emissions in 2004 were 45 percent over 1990 levels, which is three times Madrid's 2012 quota under the terms of the Kyoto Protocol. According to Ministry officials, Spanish coal plants' CO2 emissions in the first quarter of 2005 exceeded 10 million tons. In addition, they state that the Spanish government does not have the technological expertise to develop "clean coal" technology, forcing it to rely on equipment imported from Japan and Germany. A major factor that has prevented Spain from developing this technology is the country's traditionally low level of investment in research and development. In the past, Spain has allocated approximately 5 percent of aid money to research and development, well below the 14 percent average among EU countries. However, approximately 10 percent of future coal sector aid (2005-2012) is earmarked for research and development. Ministry officials estimated that the Spanish government would have to spend the equivalent of 2 percent of GDP on emission credits in the future to meet its Kyoto Protocol obligation, providing added impetus for greater investment in this area.

19. In January, the Spanish government proposed cutting emissions in coal fired plants 21 percent from 2005 to 2007. Under this plan, coal-power emission would have been limited to 55.4 million tons in 2005, falling to 43.6 million tons by 2007. Companies that exceed these emission levels would have the option of paying fines to the Spanish government or buying emission rights from other countries. At the same time, the plan would allow for an increase in emission limits for combined-cycle natural gas plants from 48.8 million tons

in 2005 to 76.8 million tons in 2007. This plan encountered stiff resistance from the country's leading coal power producer, Endesa, and the coal industry, while being supported by Iberdrola, Spain's largest combined-cycle power producer. The Spanish government eventually altered the plan, maintaining an overall decrease in emission allowances for the country's power generation industry from 89 million tons in 2005 to 87 million tons in 2007, but modifying the ratio between coal and natural gas powered facilities. The Spanish power industry expects to produce approximately 92 million tons of CO2 a year, which implies that it would have to buy extra emission credits at an estimated cost of some 10 Euros (13 USD) per ton, or 30 million Euros (39 million USD) in 2005.

//COMMENTS//

10. Coal remains a politically sensitive issue in Spain, although to a lesser degree than in previous years. Despite the fact that only 18,00 Spaniards are employed in the coal production industry, the majority of the jobs are located in the Asturias region. The Spanish government has introduced alternative plans for mining communities in conjunction with Sociedad Asturiana de Diversificación Minera (Sadim), a company that helps communities develop alternatives to coal mining. Their efforts in this field, combined with EU mandates to reduce coal production, have served to decrease the political impact of job reductions. However, it would be difficult to completely phase out coal mining because of the region's continued dependence on the industry for employment. The Zapatero government's sensitivity to public opinion ensures that any such plan will receive careful attention before it is enacted.

11. Financially, the coal issue has a different aspect. Over the past years, Spain has been called to task over alleged misuse of many of its EU subsidies, although the coal dispute has the potential to be one of the most damaging. Failure to reform the sector, per EU guidelines, could endanger future funds. Many sources have opined that the Spanish government would expend less money if it were to end domestic production, provide all coal workers with full pensions and rely solely on imported coal. With the conclusion of EU subsidies to Spain looming in the near future, this would seem to be a more economically viable solution for the Spanish government, especially given that the price of imported coal is as low as one-seventh the price of certain types of domestic coal.

12. The continued use of coal in Spain results in high pollution levels that will cause Spain to move further away from its Kyoto Protocol obligations (reftel A). The Kyoto Protocol mandates that Spanish CO2 emission levels should be only 15 percent over 1990 levels by 2012. By the end of 2004, Spanish CO2 emission levels were actually running at 45 percent over 1990 levels. Spain's Socialist government views making serious efforts to implement Kyoto targets as a central part of the "return to Europe" strategy. In part due to Kyoto-related pressure, the GOS is encouraging the increased use of renewable energies, such as wind and solar power, but the technology is not sufficient at this time to meet market demand (reftel B). Nuclear, although clean and potentially sufficient for Spain's energy needs, is politically untenable due to strong public opinion against its use (reftel C). The growing Spanish natural gas market, already the fifth largest in the world, indicates that Spain will increasingly rely on natural gas for its energy needs (reftel D). Environmental factors, combined with Spain's political reorientation and the lack of economic viability of its domestic coal production sector, will put increasing pressure on the Zapatero government to introduce strong reform of the domestic coal industry. If coal is to have a role in Spain's long-term energy mix, the Socialist government will need to commit itself to increased investment in research and development, in the hopes that it can develop more efficient processes that will allow it to protect its strategic domestic coal production capability within the constraints of a more generalized EU move away from coal production for electricity generation.

MANZANARES